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Australian Securitisation Forum

27 August 2014

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Dear Laurence

Response to Consultation Paper 221 - OTC derivatives reform

1. The Australian Securitisation Forum (**ASF**) welcomes the opportunity to respond to ASIC's proposal for amendments to the OTC derivative transaction reporting obligations under the *ASIC Derivative Transaction Rules (Reporting) 2013* (**Reporting DTRS**), as contemplated in *Consultation Paper 221 - OTC derivatives reform: Proposed amendments to ASIC Derivative Transaction Rules (Reporting) 2013* (**CP 221**).

2. We have set out our responses to the issues raised in CP 221 in Section 4. There are however additional matters not dealt with in CP 221 which the ASF would request ASIC further consider. These relate to one-sided reporting (see paragraph 4 below) and tri-party reporting (see paragraph 5 below).

3. We also attach to this response the following documents previously presented to ASIC:

   (a) Memo dated 19 May 2014 - Reporting DTRs under Australia's new OTC derivatives regime - Application to securitisation swaps: Standby Swap Provider reporting; and

   (b) Submission dated May 2014 - Proposals by the Australian Securities Investment Commission (ASIC) to Stagger and Delay Phase 3 reporting

4. One-sided reporting

4.1 *Request for on-sided reporting*: The ASF is disappointed that there has been no proposal for either an exemption for securitisation SPVs, or introduction of one-sided reporting. The ASF has previously noted in its submission entitled *Submission on Proposals by the Australian Securities and Investment Commission (ASIC) to Stagger and Delay Phase 3 reporting – May 2014* (**Phase 3 Submission**) (a copy of which is attached for your information) the reasons why it considers this to be appropriate.

The ASF again submits that an exemption be provided for securitisation SPVs, whether through an express exemption or through one-sided reporting.

We have set out further detail on this in Section 1.

4.2 *Request for grandfathering of historic trades*: In the alternate, the ASF requests that a waiver be provided for securitisation SPVs in relation to existing derivatives, such that the reporting obligations only apply in relation to derivatives entered into after a future specified date.

The advantage of this would be that it would allow the parties to agree procedure in new transaction documentation, and therefore obviate the need for extensive due diligence expense being incurred in relation to legacy transactions.

We have set out further detail on this in Section 2.

4.3 *Request for clarification of reporting requirements*: If each of these options is not acceptable, then the reporting requirements will apply to securitisation SPVs. If this is the case, then the primary matter of relevance under CP 221 to the securitisation industry is the clarifications to the delegated reporting regime (as set out in Section D of CP 221).

The ASF welcomes these changes.

We have set out further detail on this in Section 3.

We make specific responses to the queries in Section 4.

5. Tri-party reporting

The ASF also requests that ASIC clarify the position with respect to tri-party reporting.

This is an issue in a securitisation in respect of the trust manager and the standby swap providers.

The issue arises because Rule 1.2.5(2) of the DTRs imposes the reporting obligations in respect of "All OTC Derivatives to which the Reporting Entity is a counterparty". (emphasis added).

We are concerned that this will inadvertently pick up trust managers and standby swap providers who, as a legal matter, are signatories to the relevant OTC derivative (and therefore "counterparties") – but do not have any economic obligations under the OTC derivative.

The trust manager is typically a party to the OTC in order to provide directions to the securitisation SPV in respect of matters arising under the OTC. It has no payment obligations under the swap.

The position in relate to standby swap providers is set out in our memo dated 19 May 2014, a copy of which is attached for your reference.

The ASF requests that this issue be clarified. In the absence of such clarification, it will be necessary for each trust manager and each standby swap provider to obtain advice in relation to this issue, which may be costly and inefficient.

Section 1

Request for exemption or one-sided reporting

We set out in the Phase 3 Submission detailed arguments as to why we consider that there should be either an exemption for securitisation SPVs, or one-sided reporting.

We attach the Phase 3 Submission for your information, and reiterate the points raised in support of that submission.

In addition, we understand that the certain key benefits have been raised in relation to the benefits of two-sided reporting.

Although we have commented on these matters previously, we have set out below additional comments on the relevance of those perceived benefits in a securitisation context:

(a) alternative perspective on valuation and collateral

We understand that ASIC considers that one of the proposed benefits of two-sided reporting is that it provides an alternative perspective on valuation and collateral.

We note that this benefit is unlikely to be present in respect of the bulk of securitisation SPVs, as they will seek to delegate their reporting function to the swap counterparty. The valuation and collateral positions will always therefore, by definition, be the same.

(b) reconciliation of information

Further, we understand that there is perceived to be a benefit as a result of the ability for there to be reconciliation of information as provided by each counterparty.

Again, this benefit will not be present in respect of the bulk of securitisation SPVs, as they will seek to delegate their reporting function to the swap counterparty – who will just report the "mirror image" position to that it reports in respect of itself. Again, the positions will always reconcile.

Section 2

Apply reporting to new transactions only

To the extent that the ASF's submissions under Section 1 are unsuccessful, then the ASF requests that there be a grandfathering of the reporting requirements insofar as they apply to securitisation SPVs, such that they only apply in relation to derivatives entered into after a specified date (being a date following the final ASIC amendments to the reporting regime are finalised).

As currently proposed:

- position reporting;
- ongoing mark to market and collateral valuations; and
- reporting in relation to transaction amendments,

will be required in relation to all applicable derivatives, including those that remain outstanding but were entered into many years prior to the commencement of the reporting regime.

The benefit of a grandfathering approach would be that it would be possible for the securitisation SPVs to document agreed arrangements in respect of new transactions only – these could be considered and documented at the time that the broader transaction is implemented. This would be an efficient way to address this issue. To the extent that a particular swap counterparty was unwilling or unable to provide the necessary reporting, then the other transaction participants could either determine an alternative manner in which the reporting could apply, or another swap counterparty could be engaged.

The cost savings from this approach would therefore be substantial - it would not be necessary for each securitisation SPV to undertake due diligence of existing documentation in order to determine the manner in which it may delegate its responsibilities, nor address any of the other issues that this requirement raises (in each case, as set out in Section 3 below).

Section 3

Changes to delegation regime

Our response in respect of the specific queries posed by ASIC in relation to the proposed delegation regime are set out in Section 4.

We also make the following comments.

1. Response on queries

Paragraph D1(c) of CP221 provides that a condition of the safe harbour is that:

> *"the reporting entity makes regular inquiries that are reasonably designed to determine whether the delegate is discharging its obligations under the terms of its appointment."*

The ASF would appreciate more specificity as to what would be necessary to satisfy this requirement, including clarification about the following aspects:

(a) requirement for the reporting entity to make inquiries – as previously noted, the Australian securitisation market operates on the basis of a sub-contracted model, in that the securitisation SPV sub-contracts all its operational responsibilities to other parties.

Typically most matters in respect of administration, such as any communication with other parties as to their compliance with obligations, would be delegated to the trust manager.

Accordingly, it should be clarified that the safe harbour would continue to apply for securitisation SPVs in circumstances where the trust manager makes these regular inquiries on behalf of the trustee.

(b) requirement for regular inquiries – it would be appreciated if the regularity that is required in order to satisfy this could be clarified. Is this in any way related to the payment obligations under the swap, or is annual inquiry sufficient? This is particularly the case given the requirement under the Reporting DTRs to provide daily reporting on some matters.

(c) inquiries reasonably designed to determine whether the delegate is discharging its obligations – it should be clarified as to whether the act of inquiry is sufficient, or whether something else is envisaged.

Clarification of these matters would be of great assistance in providing the confidence for the securitisation SPVs to delegate.

2. Residual risks of delegation

However, it is important to explain that while the proposed clarification of the safe harbour position is welcome, introduction of a delegation regime does not fully address the issues for the securitisation industry.

For the reasons set out below, the effect of this is that the delegation regime does not equate to *de facto* one-sided reporting, as we understand has been suggested. The reasons for this are as follows:

A securitisation SPV is not like a normal operating trust or company. Its activities are constrained by the terms of its constituent documents and its funding arrangements – each of which will typically limit its powers to the entry into, and the performance of, a specific and limited set of documents and transactions. This is usually a requirement of both rating agencies and financiers – as the financing is provided on a limited recourse basis, it is important that the securitisation SPV only enters into transactions that align with the financial analysis undertaken by those parties.

The securitisation SPV would therefore not be permitted to act beyond those pre-agreed parameters without the consent of those parties and possibly others. This raises the following issues:

(a) In order for a securitisation SPV to be able to delegate any of its responsibilities, it must be permitted to do so under the documents.

The documents often specify a liability regime that is to apply in respect of any delegation. This would need to be reviewed in light of the proposed arrangements set out in CP 221.

This therefore requires a due diligence review of its constituent documents. This would be required for each of the 500+ securitisation trusts in the market.

(b) Similarly, the financiers of securitisations SPVs often have additional control and consent rights in respect of delegations.

So a further due diligence review of the financing documents would be required. Again, in the context of 500+ securitisation trusts, this may be an expensive process. The costs of this review would be passed on to the sponsor of the securitisation SPV.

(c) Part of this review would be to assess the liability and oversight regime that applies over and above that contemplated in CP 221 – that is, the financiers may mandate that the actions of a delegate be monitored in a particular manner. The costs of this would need to be passed on by the securitisation SPV to the sponsor of the securitisation SPV.

It should be noted that the trustees will want to carefully check these items, as failure to comply with the documentation requirements <u>may render the trustee personally liable</u>. The usual arrangement is for the trustee's personal assets not to be available to the creditors of the securitisation SPV, other than where there is fraud, negligence or wilful default on the part of the trustee.

This will be a significant issue for trustees, so they will want to carefully undertake and assess due diligence in respect of this issue.

(d) It will also be necessary to re-design the reporting systems to allow for the regular inquiries required under proposed CP221.

As noted above, a trustee would not otherwise be required under the documentation to make inquiries of any party in the transaction – due to the sub-contracted model adopted for securitisations, the trustee is typically expressly not required to make

any inquiries of any other party, and would typically rely on the trust manager to undertake all actions. Proposed CP 221 would fundamentally change this requirement.

The above is of course premised on the assumption that the relevant swap counterparty is prepared to accept a delegation. The may well be commercial reasons why in any particular situation, a swap counterparty in respect of currently existing swaps is not prepared to accept delegation. If this is the case, then the securitisation SPV would need to make alternative arrangements. Practically, this means that each of the corporate trustee companies will need to invest in the infrastructure/processes, or otherwise have in place alternative arrangements, in order to be able to undertake the reporting on this residual number of swaps. The cost of this would therefore be disproportionate as it would likely need to be absorbed across a small number of swaps.

Section 4

Response to specific ASIC queries

The ASF sets out below its response to the queries raised by ASIC in CP 221.

The ASF makes no submission in respect of the matters set out in sections B and C of CP 221.

In respect of the matters set out in section D of CP 221, the ASF makes the following submissions:

<u>Text of Proposal:</u>

D1 *We propose to amend Rules 2.2.6 and 2.2.7 in relation to delegated reporting to provide a 'safe harbour' from enforcement action if certain conditions are met—that is, a reporting entity is not responsible for a breach of the relevant rules for a reportable transaction or reportable position, provided that the reporting entity delegates the reporting obligation to another entity (the 'delegate'), and:*

(a) the terms of the delegate's appointment and any related agreements or arrangements are documented in writing;

(b) the appointment, agreements and arrangements between the reporting entity and the delegate provide that the delegate will:

(i) report on behalf of the reporting entity in relation to the reportable transactions and reportable positions in accordance with Rules 2.2.1 to 2.2.5; and

(ii) take all reasonable steps to ensure that the information, and any changes to the information, reported on behalf of the reporting entity under Rules 2.2.1(1) and 2.2.2(1) in relation to the reportable transactions and reportable positions is and remains complete, accurate and up-to-date; and

(c) the reporting entity makes regular inquiries that are reasonably designed to determine whether the delegate is discharging its obligations under the terms of its appointment.

<u>Items on which feedback sought:</u>

D1Q1 *Do you agree with this proposal? If not, why not?*

The ASF supports all actions taken to clarify the liability regime in respect of delegation.

D1Q2 *Do you consider that this proposal will encourage the use of delegated reporting? If not, why not?*

Yes.

D1Q3 *Will a 'safe harbour' for delegated reporting reduce your costs of implementing transaction reporting? If so, please provide details.*

In respect of securitisation SPVs, no.

This is because:

(a) as noted above, in order to permit a securitisation SPV to delegate its reporting obligations, the constituent and financing documents of each such securitisation SPV will need to be reviewed – in order to determine if, and on what basis, delegation may occur. Although the cost of this on a per trust basis is not substantial, it will be substantial in aggregate across the industry (500+ trusts);

(b) there may be costs payable by the securitisation SPV to the delegate in consideration for it reporting on behalf of the securitisation SPV; and

(c) it will be necessary for the securitisation SPVs, which rely on a fully outsourced model (that is, all obligations are outsourced to other parties), to introduce into their operating structures a mechanism by which to make regular inquiries as to reporting compliance.

D1Q4 *Are there any other proposals that may meet our regulatory objective of encouraging the use of delegated reporting? If so, please provide details.*

No.

While clarification of the proposed liability regime is of some assistance, the fundamental issue is that for so long as securitisation SPVs have a positive obligation to either report or delegate, there is an incremental performance obligation on securitisation SPVs that is contrary to the manner in which the securitisation industry has successfully operated for many years – without any incremental benefit, as there is no alternative perspective on valuation/collateral, and no reconciliation of information.

Memo

19 May 2014

To: **Laurence White, Michael Cleland, Philip Charlton, Keith Faassen, Rhonda Luo, Adam Coleman, Benjamin Cohn-Urbach, Australian Securities and Investments Commission (ASIC)**

From: **Australian Securitisation Forum (ASF) OTC Derivatives Working Group**

Reporting DTRs under Australia's new OTC derivatives regime - Application to securitisation swaps: Standby Swap Provider reporting

1. We refer to our meeting on 17 March 2014 to further discuss tri-party reporting and delegation issues relevant to the securitisation industry under Australia's new mandatory OTC reporting regime.

2. Based on that meeting, we understand that ASIC is sympathetic to our view that a manager of a securitisation programme should not be required to report a securitisation swap that it has entered into in circumstances where it has no direct payment obligations under the swap.

3. In addition, we understand that ASIC is considering whether a Standby Swap Provider's position is similar to that of a trust manager's. To assist ASIC's further consideration of this issue, please see attached samples of the following documents:

   (a) draft ISDA Schedule under which a Standby Swap Provider has been appointed to support the obligations of the Swap Provider under a fixed rate swap;

   (b) draft Trust-level Credit Support Annex (**CSA**) referred to in (a); and

   (c) draft Standby Swap Provider CSA referred to in (a).

4. A summary of the Standby Swap Provider's obligations under the standby arrangements documented by the above terms is set out in the Schedule to this memorandum.

5. We have noted in the summary the following features of a Standby Swap Provider arrangement which we believe support our view that a Standby Swap Provider should not be required to report a securitisation swap that it has entered into in circumstances where it has no direct payment obligations under the swap:

   (a) The Standby Swap Provider's commitment requires it to support the Swap Provider's payment obligations where it is not sufficiently rated and defaults on payments to Party B. In these circumstances, the Standby Swap Provider must pay Party B the defaulted amount and the Swap Provider must separately reimburse the Standby Swap Provider for its payment. Importantly, this obligation does not arise under the fixed rate swap, but under the terms of the underlying ISDA. As noted in previous discussions, this arrangement is similar in nature to a guarantee of the Swap Provider's obligations.

   (b) Although the Standby Swap Provider is a party to the fixed rate swap (see Annexure C to the ISDA Schedule), it does not have any obligations under the fixed rate swap in its Standby Swap Provider capacity. If the Swap Provider fails to make the reimbursement payment referred to above, this will lead to an automatic novation of the fixed rate swap to the Standby Swap Provider as Party A. It is only at this point (i.e. when it is acting in its capacity as Party A) that the former Standby Swap Provider will have a direct economic exposure under the fixed rate swap.

(c) Collateral posted by the Standby Swap Provider under the Standby Swap Provider CSA is not used to support any of the payments owed by Party A to Party B under the Fixed Rate Swap. It's function is strictly confined to supporting the obligations of the Standby Swap Provider under its standby commitment (ie it collateralises the Standby Swap Provider's obligations only, as opposed to the Swap Provider's obligations).

(d) This is reinforced by Part 5(aa) of the ISDA Schedule which provides that if there is a swap close-out prior to the Novation Date (ie the date that the Standby Swap Provider becomes Party A), the collateral posted by the Standby Swap Provider, the collateral posted by the Standby Swap Provider will not be included in the calculation of the net close-out amount due between Party A and Party B.

6. We look forward to discussing further with you tomorrow.

Schedule

Summary of Standby Swap Provider's Obligations		
	Provision Reference	**Standby Swap Provider obligations**
1.	Part 1(f)(ii)(B): Additional Termination Event	If an S&P Replacement Event or S&P Collateralisation Event occurs (see item 7 below) in relation to the Standby Swap Provider, the Standby Swap Provider must comply with the S&P rating requirements outlined in item 10 below. If it fails to do so, this will trigger an Additional Termination Event.
2.	Part 2(a)/2(b): Tax Representations	The Standby Swap Provider is required to make certain tax representations.
3.	Part 3(a)/3(b): Agreement to deliver documents: tax forms; documents or certificates to be delivered	The Standby Swap Provider is obliged to deliver certain documents under the ISDA.
4.	Part 5(f): Failure to pay or deliver	Modifies the payment event of default so that (1) a failure by the Swap Provider to pay Party B will be cured if the Standby Swap Provider makes the payment to Party B in place of the Swap Provider and (2) a failure by the Swap Provider or Standby Swap Provider to deliver collateral and comply with any of its other obligations under a Credit Support Annex will not trigger a payment default
5.	Part 5(n): Definition of Credit Support Annex	Defines Credit Support Annex as either the Trust Credit Support Annex (**Trust CSA**) or the Standby Swap Provider Credit Support Annex (**Standby Swap Provider CSA**). The Trust CSA documents the terms on which the Swap Provider is required to post collateral if it does not have the minimum ratings. This serves the same function as the CSA forming part of the ISDA that we have previously provided in relation to a non-standby swap provider transaction except that no collateralisation obligations will arise for the Swap Provider while the Standby Swap Provider commitment is on foot. The Standby Swap Provider CSA documents the terms on which the Standby Swap Provider is required to post collateral in the

		event that it is downgraded and has not taken any of the steps outlined in item 10 below. If the Standby Swap Provider is not downgraded, or is downgraded but taken one of the steps outlined in item 10, it will not be required to post any collateral under the Standby Swap Provider CSA.
6.	Part 5(n): Definition of Fixed Rate Swap	This definition contemplates that the Standby Swap Provider will be a party to the Fixed Rate Swap. However, the form of the Fixed Rate Swap Confirmation in Annexure C shows that the Standby Swap Provider does not have any obligations under the Fixed Rate Swap in its Standby Swap Provider capacity. Its obligations under the Fixed Rate Swap do not arise until the Fixed Rate Swap is novated to it and, at that point, it has replaced the original Swap Provider as Party A.
7.	Part 5(n): Definition of Minimum S&P Uncollateralised Counterparty Rating	The definition of "Minimum S&P Uncollateralised Counterparty Rating" is used in the definitions of "S&P Replacement Event" and "S&P Collateralisation Event". An S&P Replacement Event is triggered if the current rating of Party A or the Standby Swap Provider falls below the Minimum S&P Uncollateralised Counterparty Rating (namely the minimum current rating of a counterparty that will not, without any collateral having to be currently provided in accordance with the Standby Swap Credit Support Annex, cause a downgrade, withdrawal or qualification of the current rating of the Notes as determined in accordance with Annexure B, or as otherwise determined in accordance with S&P criteria). An S&P Collateralisation Event will be triggered if the current rating of Party A or the Standby Swap Provider falls below the Minimum S&P Uncollateralised Counterparty Rating for a certain period and Party A or the Swap Provider, as applicable, has not (1) novated its position to an entity with at least the Minimum S&P Uncollateralised Counterparty Rating, (2) obtained a guarantee of its obligations from an entity with at least the Minimum S&P Uncollateralised Counterparty Rating, or (3) entered into other arrangements which will not affect the rating of the Notes
8.	Part 5(r): Standby Swap Provider's Commitment	Under a new Section 17(a), if the Swap Provider does not have the Prescribed Ratings (i.e. the Minimum S&P Uncollateralised

		Counterparty Rating) and fails to make payments to Party B under the ISDA, the Standby Swap Provider is required to pay Party B the net amount then owing by the Swap Provider to Party B under the fixed rate swap. Under a new Section 17(b), the Swap Provider is required to reimburse the Standby Swap Provider for its payment under 17(a). If the Swap Provider fails to make the reimbursement payment, this will lead to an automatic novation of the Fixed Rate Swap to the Standby Swap Provider as Party A. It is only at this point (i.e. when it is acting in its capacity as Party A) that the former Standby Swap Provider will have a direct economic exposure under the Fixed Rate Swap. Section 17(e) contemplates that the Swap Provider and Standby Swap Provider may enter into a Credit Support Annex to enable the Swap Provider to post collateral with the Standby Swap Provider in support of the Standby Swap Provider's obligations under 17(b). Under new 17(i), the Standby Swap Provider is a party for limited purposes. Although this includes Section 2 of the ISDA, this is simply to recognise that the collateral posted by the Standby Swap Provider will be posted (and the commitment that it makes under the new Section 17 will be payable) pursuant to Section 2. It does not recognise any direct payment obligations that the Standby Swap Provider has under the Fixed Rate Swap in its Standby Swap Provider capacity. New 17(j) documents the novation fee that will be payable to the Standby Swap Provider. New 17(k) protects against the Standby Swap Provider's commitment escalating without its consent.
9.	Part 5(s): S&P Replacement Event or Collateralisation Events in respect of the Swap Provider	Outlines the actions required of the Swap Provider following an S&P Replacement Event or an S&P Collateralisation Event in the event that the standby commitment in Section 17 no longer applies. If an S&P Replacement Event occurs in these circumstances, the Swap Provider must (1) novate its position to an entity with at least the Minimum S&P Uncollateralised Counterparty Rating, (2) obtain a guarantee of its obligations from an entity with at least the

		Minimum S&P Uncollateralised Counterparty Rating, or (3) enter into other arrangements which will not affect the rating of the notes. An S&P Collateralisation Event will be triggered if the rating of the Swap Provider falls below the Minimum S&P Uncollateralised Counterparty Rating for a certain period and the Swap Provider has not taken any of the actions outlined in (1), (2) or (3) above. If an S&P Collateralisation Event occurs in respect of the Swap Provider in circumstances where the standby commitment in Section 17 no longer applies, the Swap Provider must post collateral on the terms set out in Part 5(s).
10.	Part 5(t) (i) - (iii): Standby Swap Provider downgrade	Outlines the consequences of a Standby Swap Provider downgrade which triggers an S&P Collateralisation Event or S&P Replacement Event in relation to the Standby Swap Provider. If an S&P Replacement Event occurs in respect of the Standby Swap Provider, it must (1) novate its position to an entity with at least the Minimum S&P Uncollateralised Counterparty Rating, (2) obtain a guarantee of its obligations from an entity with at least the Minimum S&P Uncollateralised Counterparty Rating, or (3) enter into other arrangements which will not affect the rating of the Notes. If an S&P Collateralisation Event occurs in respect of the Standby Swap Provider, it must comply with its obligations under the Standby Swap Provider CSA and may take any one of the actions outlined in (1), (2) or (3) above.
11.	Part 5(t)(iv): Standby Swap Provider Collateral Account	Establishes the collateral account into which the proceeds of collateral posted by the Standby Swap Provider are paid. Part 5(t)(iv) provides that the collateral can only be withdrawn from the account for the purposes of a novation of the Standby Swap Provider's position under the Fixed Rate Swap, delivering any collateral to the Standby Swap Provider, withdrawing any amount incorrectly deposited, paying bank account taxes etc or funding amounts due to be paid by the Standby Swap Provider following a failure by the Standby Swap Provider to pay such amounts. Importantly the collateral is not used to support any of the payments owed by Party A to Party B under the Fixed Rate

		Swap. Part 5(t)(v) provides for the return of the Standby Swap Provider's cash collateral where it is no longer required to support the credit of the Standby Swap Provider (see Part 5(t)(v) for a list of circumstances where the cash collateral is no longer required).
12.	Part 5(x): Amendments	Protects the Standby Swap Provider against amendments to the broader transaction documents which could have a material adverse effect on the Standby Swap Provider's position.
13.	Part 5(z): Reporting	Provides for certain reports to be provided to the Standby Swap Provider.
14.	Part 5(aa): Early Termination Date: Standby Swap Provider Credit Support Annex	Provides that if there is a swap close-out prior to the Novation Date (ie the date that the Standby Swap Provider becomes Party A), the collateral posted by the Standby Swap Provider will not be included in the calculation of the net close-out amount due between Party A and Party B.

Submission on Proposals by the Australian Securities Investment Commission (ASIC) to Stagger and Delay Phase 3 reporting – May 2014

Introduction

1. The Australian Securitisation Forum (**ASF**) welcomes the opportunity to respond to ASIC's proposal for a staggered and delayed start to Phase 3 of the OTC derivative transaction reporting obligations under the *ASIC Derivative Transaction Rules (Reporting) 2013* (**Reporting DTRS**).

2. In broad terms, the ASF welcomes the proposal as a first step towards recognising a number of barriers to implementation of Phase 3.

3. At the same time, the ASF strongly supports ASIC taking further steps to exempt securitisation trustees from reporting under Phase 3 altogether on the basis that the costs of securitisation trustees complying with a mandatory reporting obligation will be significant (including in contrast to other Phase 3 entities) and outweigh the regulatory benefit of the reporting obligation.

Arguments for Exemption

4. In considering whether securitisation trustees should be exempted from reporting, the ASF strongly encourages ASIC to take into account the following factors, which we submit also differentiate securitisation trustees from the circumstances applying to other Phase 3 entities:

   a. securitisation trustees are essentially passive entities in securitisation programmes and have no operational capacity (including no employees, surplus funds etc) beyond the specific transaction for which they were established. This requires securitisation trustees to operate via an outsourcing model which in turn requires them to delegate all of their obligations, including their reporting obligations. Any reporting obligations are likely to be delegated to the swap counterparty (being the only party that has the relevant information). This means the reconciliation benefits of double-sided reporting will not be relevant to securitisation trustee reporting.

   b. the reporting fields prescribed by the Reporting DTRs do not allow certain features of securitisation swaps to be reported. Under the Reporting DTRs the original notional and maturity date of securitisation swaps will be reported. During their life, as the underlying assets pay down, the notional amount of securitisation swaps will also be amortised and amended to reflect these paydowns. This however is not an event that is required to be reported to the trade repository. Similarly as the average life of the underlying assets reduces, the life of a securitisation swap will also be reduced but not reported. As a result, the position of a securitisation swap in the trade repository will not be reflective of its current position. Conversely any valuations associated with the securitisation swap that are reported to the trade repository will be based on the current exposure. This may also result in reported securitisation swap valuations looking off market in relation to reported securitisation swap positions. In summary, the nature of the notional profile of securitisation swaps means that certain of their swap features

cannot be accurately and consistently reported in a meaningful manner, and in fact could result in the reporting of potentially misleading information.

c. the number of securitisation swaps per reporting entity is limited to a small number of trades, relative to the costs associated with the compliance burden (usually 1-2 swaps per securitisation trustee when issuing domestically and up to 3 swaps when issuing offshore; there are some programmes where fixed rate loans are hedged on a loan by loan basis – but this is less common). These costs would include expenses associated with establishing reporting systems and processes and negotiating and documenting delegation arrangements, including the terms by which delegates will be compensated. We refer you to Section 4 of our submission to the Treasury on the G4-IRD central clearing consultation (**G4-IRD Submission**), a copy of which we have enclosed, for a detailed explanation of these costs. While many Phase 3 entities may face similar costs, the impact of this costs will be far more onerous for securitisation trustees because of the relatively small number of swaps for which the costs would be incurred; resulting in a per swap cost of compliance that would far exceed that incurred by most other Phase 3 entities.

d. the vast majority of the counterparties to swaps entered into by securitisation trustees will be Phase 1 or 2 entities who are already required to report or domestic Phase 3 ADI entities who will be required to report once Phase 3 comes into force. This observation is supported by feedback received by the ASF in connection with an informal survey it has conducted across its membership base in relation to programmes rated by Fitch (which should be representative of the industry). Based on this feedback (see spreadsheet attached), in the Fitch-rated group, all counterparties to swaps entered into by securitisation trustees since 2011 have been Phase 1, Phase 2 or domestic Phase 3 entities. Moreover, pre-2011 exposures to non-domestic Phase 3 entities are limited to 18 swaps entered into by foreign banks between 2006 and 2010.

e. one of the main purposes of the G20 reforms is to reduce systemic risk. Securitisation trustees already mitigate systemic risk arising from their reliance on OTC derivatives through their use of certain legal and structural protections including ensuring that all derivatives exposures are created for very specific hedging purposes and fully secured against assets that have been quarantined from insolvency. See paragraphs 16-19 of our G4-IRD Submission for further details in relation to these structural and operational features. As a result of these features, Australian securitisation transactions already build in robust protections against systemic risk. Imposing a reporting mandate on securitisation trustees will not reduce systemic risk beyond the levels already achieved through these protections.

5. These 5 factors differentiate securitisation trustees from other Phase 3 entities and significantly reduce the regulatory benefit of requiring securitisation trustees to report (including when compared to other Phase 3 entities).

6. In addition, the cost impacts of reporting will have serious economic consequences for the securitisation industry, with flow on consequences for the broader economy. In particular, the significant restructuring and costs that the industry will need to incur to accommodate reporting could cause a slowing down of the securitisation market as new delegation arrangements and rating agency criteria are developed. This may, in turn, limit the economics of securitisation transactions and restrict their availability as a funding tool, which will further erode competition within the banking sector. We believe that these cost impacts will be quite significant and outweigh the value of any data that is likely to be reported to regulators.

7. We have attached, as a schedule to this submission, some suggested wording which could be used as a basis for such an exemption. We would of course be pleased to discuss this further with you.

Single sided reporting

8. Besides the specific exemption discussed above, a reporting exemption for securitisation trustees would also be achieved through a move to single-sided reporting for Phase 3 entities or treating securitisation trustees as end users. Any of these approaches would be acceptable to the ASF provided, to the extent an exemption is achieved via the introduction of single-side reporting, the reporting responsibility always defaults to the swap provider, regardless of whether the swap provider is a Phase 1 entity, a Phase 2 entity or another Phase 3 entity.

9. Our working assumption behind proposing this default position is that securitisation trustees will always face Phase 1, Phase 2 or Phase 3 entities who will be required to report to ASIC under the Reporting DTRs. The only circumstances where our assumption may be incorrect should be limited to situations where swaps have been provided by Phase 3 entities who are foreign banks and book their trades offshore and don't enter into the swap in Australia.

10. The average life of a swap in a securitisation programme is 5 to 6 years. Anecdotally, we are not aware that any foreign banks have provided swaps to securitisation programmes since 2011 (refer 4(d) above). To the extent that swaps have been provided by foreign banks prior to 2011, and these have been booked offshore and not entered into by the foreign bank in Australia, it is likely that most of these swaps will be nearing the end of their average life and hedging de minimis amounts by October 2015 (or at least by 6 months after this date, when position reporting will come into force for all Phase 3 entities). Practically, there would seem to be little regulatory benefit in the reporting of these swaps. Further, given the eligibility requirements that ratings agencies impose on securitisation swap providers, it is likely that swap providers to Australian securitisation programmes will predominantly be Phase 1, Phase 2 or domestic Phase 3 entities going forward.

11. Therefore, the risk of single-sided reporting leading to unreported securitisation swaps is in the ASF's view extremely low and limited to circumstances where swaps have been provided by foreign banks and booked offshore and not entered into by the foreign bank in Australia. As these types of swaps are likely to represent a very small proportion of the domestic market's overall securitisation swap exposures, the ASF submits that their incidence is not significant enough to warrant imposing an obligation on a securitisation trustee to report when facing foreign banks in these circumstances. This is because the costs of anticipating the default position (i.e. building delegation arrangements etc) would undermine any benefits achieved for securitisation trustees if they are not required to report when facing Phase 1 entities, Phase 2 entities or other Phase 3 entities.

12. We note that a hybrid approach of Phase 3A non single-sided reporting and Phase 3B single-sided reporting would have similar drawbacks. As securitisation trustees could fall into both Phase 3A or 3B, this would result in additional compliance overheads for securitisation trustees as they would be required to monitor whether they might go over the threshold, and as swaps mature come under again. It would also require securitisation trustees to anticipate falling into Phase 3A and again, incur costs to build delegation arrangements etc in contemplation of this, which would defeat the benefits of single-sided reporting for securitisation trustees in the first place.

Conclusion

13. Securitisation trustees should be treated as end-users for trade reporting purposes or otherwise exempted from the requirement to report securitisation swaps through specific relief or the introduction of single-sided reporting for Phase 3 entities which would effectively result in a reporting exemption for securitisation trustees. This approach would recognise that Australian securitisation transactions already build in robust protections against systemic risk, and that imposing a reporting mandate on securitisation trustees will not reduce systemic risk beyond the levels already achieved through these protections. This approach will also ensure that a reporting mandate will not subject the securitisation industry (and therefore the mortgage market) to costs which are not justified by the regulatory benefit. This result would be consistent with the government's stated objectives of reducing red tape to decrease the cost of doing business in Australia. It will also avoid the potential for these costs to cause a slowing down of the securitisation market or limit the economics of securitisation transactions, which could in turn restrict their availability as a funding tool, which will further erode competition within the banking sector.

Thank you for the opportunity to make this submission. If you have any questions on our submission, please contact Chris Dalton on (02) 8243 3906.

Yours sincerely

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Chair of the Australian Securitisation Forum OTC Working Group on Derivatives Reforms
6 June 2014

Schedule

Proposed wording for securitisation SPV reporting exemption

1. Exemption sought

That each Exempt Securitisation Entity is not a Reporting Entity .

2. Definitions

Terms defined in the DTRs have the same meaning when used in this document, unless the context otherwise requires.

Exempt Securitisation Entity means a body corporate or a trust that:

[Comment – this reflects paras (a) and (b) of the definition of "securitisation entity" in para 3.4, Schedule 3 of the NCCP Regulations.]

(a) carries on a business consisting of managing by way of a securitisation transaction some or all of the economic risk associated with assets, liabilities or investments (whether the body corporate or trust assumes the risk from another person or creates the risk itself); and

(b) is an insolvency remote special purpose funding entity according to the criteria of an internationally recognised rating agency that are applicable to the circumstances of the body corporate or trust (regardless of whether the agency has determined that the body corporate or trust satisfies the criteria).